POWERS OF THE A.O. ARE NOT PLENARY OR UNBRIDLED, EVEN AFTER THE AMENDMENT OF S.147, W.E.F. 1.4.1989

[Even in a case where no assessment has been made under section 143(3), the AO cannot initiate action under section 147, without new or fresh material or information, in his possession]

[Published in CTR Vol. 182 (Art.) p.49 (part II)]

- By S.K.Tyagi

1. INTRODUCTION

Recently, I had an occasion to deal with a case, where no notice under section 143(2) of the Income-Tax Act, 1961 (the Act), was served on the assessee, within the stipulated period of twelve months. But after the expiry of the aforesaid period, the Assessing Officer (AO) issued a notice under section 148 read with section 147 of the Act. We requested the AO to supply us the reasons recorded under section 148, which the AO did. From the reasons recorded under section 148, it was evident that the AO had no fresh information or material in his possession so as to initiate action under section 148. The AO simply stated in the reasons that the two items of expenditure claimed as deduction under section 37(1), were prima facie of capital nature. The details in respect of the aforesaid two items of expenditure had been furnished by the assessee, in the covering letter enclosed with the return of income. In such a case, the correct course of action on the part of the AO was to issue notice under section 143(2), within the stipulated period of twelve months. Once having opted not to issue notice under section 143(2), the AO cannot initiate action under section 147, to achieve the same objective. The proceedings initiated under section 147, were, therefore, challenged by furnishing detailed reasons against such action.

While we were preparing our submissions challenging the notice under section 148 of the Act, a recent judgement of the Apex Court, in the case of *GKN Driveshafts (India) Ltd. Vs. ITO* [2002] 259 ITR 19 (SC) came to our notice. This is a landmark judgement in respect of two issues, -

(i) It is held in this judgement that if after furnishing the return in response to notice under section 148, the assessee desires to seek reasons recorded by the AO before the issuance of such notice, then the AO is bound to furnish the same within a reasonable time.

(ii) On receipt of the reasons recorded, the assessee is entitled to file objections against the issuance of notice under section 148 and the AO is bound to dispose of the same by passing a speaking order, before proceeding with the assessment.

Thus, the Apex Court has settled two issues vide the aforesaid judgement –

(i) In case the assessee desires to seek the reasons recorded under section 148, the AO is bound to furnish the same within a reasonable time, and

(ii) If the notice under section 148 is challenged, then the AO is bound to dispose of the objections against such notice by passing a speaking order, before proceeding with the assessment.

From the aforesaid judgement, it is now clear that if the AO, along with issuance of notices under sections 148 and 143(2), calls for various details regarding the assessment to be re-opened, then the assessee need not furnish such details, till the objections furnished against the notice under section 148, are disposed of by the AO by passing a speaking order.

2. Widespread erroneous impression regarding the provisions of amended S.147

Of late, an erroneous impression is gaining ground that under the provisions of amended section 147, with effect from (w.e.f.) 1.4.1989, the AO has unbridled powers to assess or re-assess income which has escaped assessment. This is so, particularly in respect of cases where no assessment has been made under section 143(3). Such an impression has become widespread in view of a few erroneous judgements, which do not represent the correct view regarding the scope of the amended provisions of section 147 of the Act. This would become clear in the ensuing paragraphs.

3. Brief comments regarding the amendment of section 147

There has been a major change in the provisions of section 147 after its amendment, vide the Direct Tax Laws (Amendment) Act, 1987, w.e.f. 1.4.1989.

By the Direct Tax Laws (Amendment) Act, 1987, a new scheme of assessment has been introduced in the newly substituted section 143 of the Income-Tax Act, 1961, w.e.f. 1st April, 1989. Under the new scheme, returns filed will now be accepted as such and passing of assessment orders will not be necessary. It follows that in majority of cases there would not be any application of mind by the AO after the returns are filed, unless the case is picked up for scrutiny and a regular assessment order is passed under section 143(3). The Amending Act, 1987, has, therefore, rationalized the provisions of section 147 and other connected sections to simplify the procedure for bringing to tax the income, which escapes assessment.

Under the newly substituted section 147, w.e.f. 1st April, 1989, the AO, if he has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, has been empowered, subject to the provisions of sections 148 to 153, to assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under section 147, or to re-compute the loss or the depreciation allowance or any other allowance, as the case may be, for the relevant assessment year.

Initially, the words “has reason to believe” were omitted from section 147, by the aforesaid amendment. However, a number of representations were made against the omission of words “has reason to believe” from section 147 and their substitution by the “opinion” of the AO. It was pointed out that the meaning of the expression, “reason to believe” had been explained in a number of Court rulings in the past and was well-settled, and its omission from section 147 would give arbitrary powers to the AO to re-open past assessments, on mere change of opinion. To allay these fears, the Amending Act, 1989, has again amended section 147 to re-introduce the expression “has reason to believe” in place of the words “for reasons to be recorded by him in writing; is of the opinion”.

Vide para (7.3) of Circular No.549, dated 31.10.1989, Explanatory Notes have been provided in respect of "Deemed cases of income escaping assessment (Explanation 2 to section 147). The same is reproduced, as follows:

7.3 *Deemed cases of income escaping assessment (Explanation 2 to section 147):* Under the old provisions of Explanation 1 to section 147, income chargeable to tax was deemed to have escaped assessment if it had been under-assessed or assessed at too low a rate or if any excessive relief or loss or depreciation allowance had been allowed. The new provisions in this respect, as contained in Explanation 2 to new section 147, are more elaborate and cover those cases where assessments have been completed (called as scrutiny cases) as well as those cases where no assessments have been completed (called as non-scrutiny cases). Thus, the new Explanation 2 to the section clarifies that the following shall be deemed to be cases of income escaping assessment:

(i) Where no return of income has been furnished by the assessee, although the total income is above the taxable limit.

(ii) Where a return of income has been furnished, but no assessment has been made (i.e., in a non-scrutiny case)- if the assessee is found to have understated his income or claimed excessive loss, deduction, allowance or relief in the return.

(iii)Where an assessment has been made (i.e., in a scrutiny case) – if income chargeable to tax has been under-assessed or assessed at too low a rate or if any excessive relief or loss or depreciation allowance or any other allowance under this Act has been allowed.

From the aforesaid Circular of the CBDT, it is quit evident that no distinction under section 147 is contemplated between the assessment under section 143(3) called as scrutiny assessment and the assessment accepted under section 143(1) of the IT Act.

4. Proceedings for assessment stand terminated, if no notice under section 143(2), is served on the assessee, within the stipulated period of twelve months.

There is a very important judgement in the case of *Vipan Khanna Vs. CIT* [2002] 255 ITR 220 (P&H). In this case, it was held, inter-alia, that another important change incorporated in section 143(2) of the Act, is that the notice under this sub-section cannot be served on an assessee after the expiry of twelve months from the end of the month in which the return is filed. **Therefore, in a case where a return is filed and it is processed under section 143(1)(a) of the Act and no notice under section 143(2) of the Act thereafter is served on the assessee within the stipulated period of twelve months, the assessment proceedings under section 143 come to an end and the matter becomes final**. **Thus, although technically no assessment is framed in such a case, yet the proceedings for assessment stand terminated.**

Thus, it is clear that if no notice under section 143(2) is served on the assessee within the stipulated period of twelve months, the proceedings for assessment, stand terminated. In this view of the matter, there would be no distinction between an assessment made under section 143(3) and an assessment under section 143(1)(a). Once no notice under section 143(2) is issued within the stipulated period of twelve months, the condition for re-opening the assessment will be the same, as applicable for reopening an assessment under section 143(3) of the Act.

5. The notice under section 148 is invalid in the absence of any new information / material in the possession of the AO.

It has been held in a number of judgements that the amendment of section 147, with effect from 1.4.1989, has not altered the position. The words "reason to believe" are still very much there in the main provisions of section 147 and therefore, even as per Board's Circular No.549 (*supra*), a mere change of opinion cannot form the basis for re-opening the completed assessment. If there is no change of law, no new material has come on record or no information has been received between the date of assessment sought to be re-opened and the date of formation of opinion by the AO, then it is merely a fresh application of mind by the same AO to the same set of facts.

There are a number of judgements of the Apex Court, the High Courts and the Tribunal, in support of the aforesaid proposition. These judgements / cases may be divided into three categories, viz.

Category – I : Cases where notice under section 148 was issued in respect of assessment(s), accepted or deemed to be accepted under section 143(1), for the assessment years (AYs) following or falling after 1.4.1989.

Category – II : Cases where provisions of section 147, after its amendment with effect from 1.4.1989, have been dealt with, with special emphasis on the interpretation of the expression "reason to believe".

Category – III : Other cases dealing with the expression "reason to believe" under the old provisions of section 147, before its amendment w.e.f. 1.4.1989.

All these judgements / cases are discussed, as follows:

I. Category - I

(i) *CIT Vs. S. R. Construction* [2002] 257 ITR 502 (MP).

The assessee firm was engaged in the business of building flats and selling them. In this case, the assessee filed its returns of income for the **AYs 1990-91 to 1992-93, which were accepted**. Later on, the AO issued notice under section 148 for re-opening the assessment and made reference to the Departmental Valuation Officer (DVO) to determine the cost of construction. The value adopted by the DVO was on the higher side and on that basis, the AO made certain

additions. The Tribunal set aside the assessment order, because no valid reason was recorded for re-opening the assessment, as none existed. The High Court upheld the order of the Tribunal. The observations of the Hon. High Court, on p.506 of 257 ITR, are quite relevant. The same are reproduced, as follows:

"In the instant case, since the material was placed and was accepted and no defect was found, no further material was available, hence, it cannot be said that there was any reason to believe available to the Assessing Officer to reopen the assessment".

Besides, the Hon. High Court has also made the following observations; on p.506 of the Report*:*

" Sections 147 and 148 of the Income-Tax Act, do not vest uncontrolled and arbitrary power in the Income-Tax Officer. Sub-section (2) of section 148 contains built-in safeguard to disclose reason for reassessment to the assessee. The recording of reasons under section 148(2) is not an idle formality but is a mandatory requirement of the statute, which casts a duty and obligation on the Income-Tax Officer to record his reason for issuing a notice for re-opening an assessment. Issue of notice has to be justified on the basis of reason recorded for reopening the assessment as held by this court in *CIT Vs. Thakurlal* [1981] 132 ITR 398, 400 (MP). The same is the view taken by the various other High Courts.

True it is that the existence of **reason for belief** that income escaped assessment, is certainly justiciable but not sufficiency of reasons. In the instant case, there was no reason to reopen the assessment. No valid reason was recorded for reopening the assessment as none existed.**"**

In the instant case, it is an undisputed fact that no fresh / new material was available with the AO and hence, it cannot be said that there was any reason to believe, available to the AO to reopen the assessment.

It may also be noted here that in spite of the DVO's report giving higher valuation for the construction of the building, the notice under section 148 was held to be illegal and bad in law in the aforesaid case before the MP High Court.

(ii) *CIT Vs. Smt. Usha Mathur* [2001] 252 ITR 179 (P&H)

In this case, the assessment year involved was 1989-90. The original assessment for the **AY 1989-90 was completed under section 143(1) of the Act.** The assessment was reopened by issuing notice under section 148 of the Act, on the basis of the Valuation Cell's report. In the reassessment order, an addition was made relating to the sale of jewellery, even though the assessee had returned her income on the basis of previous history. On appeal, the Tribunal held that the valuation report could not be made the basis for reopening the assessment, which had already been finalized. It also deleted the addition relating to the sale of jewellery by holding that the AO could not validly reassess the income, which would amount to a review of the order.

The Hon. High Court upheld the order of the Tribunal.

(iii) *Darshan Singh Vs. AO* [2002] 123 Taxman (Mag.) 324 (Asr.T)

In this case, the assessee's **return was processed under section 143(1)(a)**. The assessee had constructed a house. The AO referred the case to the DVO. The valuation made by the DVO was more than the cost of construction shown by the assessee. Thereupon, the AO issued a notice under section 148 and added the difference between the values of the house as declared by the assessee and as reported by the DVO, to the total income of the assessee. On appeal, the Tribunal deleted the addition. The Tribunal held that there was no other material with the AO, except the report of the DVO, because the valuation report is, at best, an information about the fair market value of the capital asset. The AO was, therefore, not justified in re-opening the assessment, where there was no other material with the AO for initiating re-assessment proceedings in respect of return which had been earlier processed under section 143(1)(a).

It may be seen here that in spite of the DVO's report making higher valuation of the house constructed by the assessee, the reopening of the order under section 143(1)(a) was found to be invalid as there was no fresh material with the AO for reopening the assessment other than the DVO's report.

(iv) *Vipan Khanna Vs. CIT* [2002] 255 ITR 220 (P&H)

In this case, it was held, inter-alia, that another important change incorporated in section 143(2) of the Act, is that the notice under this sub-section cannot be served on an assessee after the expiry of twelve months from the end of the month in which the return is filed. **Therefore, in a case where a return is filed and it is processed under section 143(1)(a) of the Act and no notice under section 143(2) of the Act thereafter is served on the assessee within the stipulated period of twelve months, the assessment proceedings under section 143 come to an end and the matter becomes final. Thus, although technically no assessment is framed in such a case, yet the proceedings for assessment stand terminated.**

From the aforesaid provisions in law, it is clear that there is no distinction between an assessment made under section 143(3) and an assessment under section 143(1)(a). Once no notice under section 143(2) is issued within the stipulated period of twelve months, the condition for re-opening the assessment will be the same, as applicable for reopening an assessment under section 143(3) of the Act.

II. Category – II

(i) *CIT Vs. Kelvinator of India Ltd.* [2002] 256 ITR 1 (Del.FB)

This is a very important judgement delivered by a Full Bench of the Delhi High Court. The Hon. High Court in this case clearly held that amendment of S.147, with effect from 1.4.1989, has not altered the position. The High Court has made a reference to the Circular No.549, dated

31.10.1989 [182 ITR (St.) 1]. A perusal of clause 7.2 of the said Circular makes it clear that the amendments had been carried out only with a view to allay fears that the omission of the expression "reason to believe" from S.147, would give arbitrary powers to the AO to reopen past assessments on a mere change of opinion. It is, therefore, evident that even according to the CBDT, a mere change of opinion cannot form the basis for reopening a completed assessment.

In this connection, para (7.2) of the aforesaid Circular is very relevant and the same is reproduced, as follows:

7.3 *Deemed cases of income escaping assessment (Explanation 2 to section 147):* Under the old provisions of Explanation 1 to section 147, income chargeable to tax was deemed to have escaped assessment if it had been under-assessed or assessed at too low a rate or if any excessive relief or loss or depreciation allowance had been allowed. The new provisions in this respect, as contained in Explanation 2 to new section 147, are more elaborate and cover those cases where assessments have been completed (called as scrutiny cases) as well as those cases where no assessments have been completed (called as non-scrutiny cases). Thus, the new Explanation 2 to the section clarifies that the following shall be deemed to be cases of income escaping assessment:

(i) Where no return of income has been furnished by the assessee, although the total income is above the taxable limit.

(ii) Where a return of income has been furnished, but no assessment has been made (i.e., in a non-scrutiny case)- if the assessee is found to have understated his income or claimed excessive loss, deduction, allowance or relief in the return.

(iii) Where an assessment has been made (i.e., in a scrutiny case) – if income chargeable to tax has been under-assessed or assessed at too low a rate or if any excessive relief or loss or depreciation allowance or any other allowance under this Act has been allowed.

From the aforesaid Circular of the CBDT, it is totally clear that no distinction under section 147 is contemplated between the assessment under section 143(3) called as scrutiny assessment and the assessment accepted under section 143(1) of the IT Act.

The Hon. High Court has placed great emphasis on the expression "**reason to believe**". For this purpose, the High Court has placed reliance on its judgement in the case of *Jindal Photo Films Ltd .Vs. Dy.CIT* [1998] 234 ITR 170 (Del.). The High Court has reproduced the observations made in this case with approval, on p.13 of the Report. The relevant part thereof, is reproduced, as follows:

"Though he has used the phrase 'reason to believe' in his order, admittedly, between the date of the orders of assessment sought to be reopened and the date of forming of opinion by the Income-tax Officer, nothing new has happened. **There is no change of law. No new material has come on record. No information has been received.** It is merely a fresh application of mind by the same Assessing Officer to the same set of facts.**"** (Emphasis added)

It is, thus, clear that for an AO to have reason to believe that an income has escaped assessment, there must be a new material or information on record. He cannot reopen the assessment simply on the basis of fresh application of mind to the same set of facts.

Further, on p.19 of the Report, the Hon. High Court has made the following observations:

" We, however, may hasten to add that if 'reason to believe' of the Assessing Officer is founded on an **information which might have been received by the Assessing Officer after the completion of assessment**, it may be a sound foundation for exercising the power under section 147 read with section 148 of the Act. **"** (Emphasis added)

These observations also make it clear that for reopening the assessment, the AO must receive some material / information, after the original assessment.

(ii) *Birla VXL Ltd. Vs. ACIT* [1996] 217 ITR 1 (Guj.)

In this case, the AY involved is 1989-90. It was held in this case that howsoever wide the scope for taking action under section 148 read with newly substituted section 147, it does not confer jurisdiction upon a **change of opinion** on the interpretation of a particular provision from that earlier adopted. The relevant observations on pp.3 & 4 of the Report, are reproduced, as follows:

"Merely saying that excessive loss or depreciation allowance has been computed without disclosing the reasons which led the assessing authority to hold such a belief, in our opinion, does not confer jurisdiction on the Assessing Officer to take action under section 147 and 148 of the Act. **We are also of the opinion that, howsoever wide the scope for taking action under section 148 of the Act be, it does not confer jurisdiction on a change of opinion** on the interpretation of a particular provision from that earlier adopted by the assessing authority. For coming to the conclusion whether there has been excessive loss or deprecation allowance or there has been under-assessment at a lower rate or for applying the other provisions of Explanation 2, **there must be material that has nexus to hold an opinion contrary to what has been expressed earlier."**(Emphasis added)

From the aforesaid observations also, it is clear that for taking action under section 147, there must be new / fresh material in the possession of the AO. Otherwise, the action under section 147 will be without jurisdiction, invalid and wholly illegal.

(iii) *Garden Silk Mills Pvt. Ltd. Vs. Dy.CIT* [1999] 237 ITR 668 (Guj.)

The relevant observations of the Court are to be found on p.676 of the Report. It was held in this case that for applying the provisions of Explanation 2 to **section 147 even after its amendment, it must be on the basis of material in the possession of the AO** and it should have nexus for holding such opinion contrary to what has been expressed earlier. Even after the amendment of section 147, **mere change of opinion** does not confer jurisdiction on the ITO to initiate proceedings for re-assessment merely by resorting to Explanation 1 to section 147.

(iv) *Choudhary Motors Vs. ACIT* [2001] 75 TTJ 16 (Jd-T)

The AY involved in this case was 1990-91. The expression '**reason to believe**' came to be dealt with by the Tribunal. It was held that since **no fresh / new material / information** came on record so as to provide nexus between the material / information and the formation of requisite belief that the claim of depreciation on truck was wrong and since no depreciation was claimed, at all, on air-conditioner, initiation of proceedings under section 148 on the basis that depreciation was wrongly claimed on these items, was not valid.

(v) *United Electrical Co (Pvt.) Ltd. Vs. CIT* [2002] 178 CTR 192 (Del.)

The AY involved in this case is 1996-97. It was held in this case that power conferred on the AO, under section 147, after the amendment of section 147, with effect from 1.4.1989, is though wide but not plenary. Formation of reason to believe and recording of reasons are imperative, before the AO can re-open the completed assessment. Existence of tangible material for the formation of opinion is a pre-requisite for initiation of action under section 147. **There should be facts before the AO that reasonably give rise to the belief.**

The AO re-opened the assessment of the assessee company on the basis of a general statement of a Director of V. Ltd. (creditor) that it was lending its name to certain parties against cash payment. It had not mentioned any name, much less the name of the petitioner. There was, therefore, no information on record, which could provide foundation for the AO's belief that the petitioner's transaction with V. Ltd., was not genuine, and its income had escaped assessment. In view of these reasons, the impugned notice under section 147 was quashed.

III. Category - III

(i) *Phool Chand Bajrang Lal & Anr. Vs. ITO & Anr.* [1993] 203 ITR 456, 477 (SC).

The Apex Court, in this case, has dealt with the expression '**reason to believe**'. It was held in this case that from a combined review of the judgements of this Court, it follows that an ITO acquires jurisdiction to re-open an assessment under section 147 read with section 148, only if he has specific, reliable and relevant **information coming to his possession subsequently**. He may start re-assessment proceedings either because some fresh facts had come to light, which were not previously disclosed or some information with regard to the facts previously disclosed, comes to his possession, which tends to expose the untruthfulness of those facts. In

such a situation, it is not a case of mere change of opinion or drawing of a different inference from the same facts as were earlier available, **but acting on fresh information**.

(ii) *ITO Vs. Lakhmani Mewal Das* [1976] 103 ITR 437 (SC)

In this case, the Apex Court was dealing with – conditions precedent for reassessment and reasons for belief that income had escaped assessment.

From this judgement, one may get a clear-cut meaning of the expression '**reason to believe**'. It may be understood here that the term "reasons for the formation of belief " is equivalent to the term 'reason to believe'. In this context, the relevant observations of the Apex Court are to be found on p.448 of the Report. The same are reproduced, as follows:

" As stated earlier, the reasons for the formation of the belief must have a rational connection with or relevant bearing on the formation of the belief. Rational connection postulates that there must be a direct nexus or live link between the **material coming to the notice of the Income-tax Officer** and the formation of his belief that there has been escapement of the income of the assessee." (Emphasis added)

"At the same time, we have to bear in mind that it is not any and every material, howsoever vague and indefinite or distant, remote and farfetched, which would warrant the formation of the belief relating to escapement of the income of the assessee from assessment".

From the aforesaid observations of the Apex Court, it is absolutely clear that the expression '**reason to believe**' postulates that there must be some new or fresh material or information in the possession of the AO for the formation of belief that some income has escaped assessment. Fresh application of mind by the AO to the same set of facts, would be nothing but a mere change of opinion, which is not permissible even under the amended provisions of section 147.

It is further held that the expression "reason to believe" in section 34 (present section 147). does not mean a purely subjective satisfaction on the part of the ITO. The belief must be held in good faith; it cannot be merely a pretence. The words in the statute are **"reason to believe"** and not **"reason to suspect".** It is open to the Court to examine whether the reasons for the formation of belief have rational connection with or a relevant bearing on the formation of the belief and are not extraneous or irrelevant for the purpose of this section. To this limited extent, the action of the ITO in starting proceedings in respect of income escaping assessment is open to challenge in a Court of law.

(iii) *Raja Bahadur Motilal P. Ltd. Vs. K.R. Vishwanathan, ITO & Anr*. [1990] 183 ITR 80 (Bom.)

In this case, it was held that it is evident from a plain reading of section 147 of the Income-Tax Act, 1961, that the expression "**reason to believe that income chargeable to tax has escaped**

assessment" is common both to clause (a) and clause (b) of section 147. The only difference between the two provisions is that whereas clause (a) requires that the income chargeable to tax must have escaped assessment by reason of (i) omission or failure to make a return or (ii) non-disclosure of all material facts necessary for the assessment fully and truly, clause (b) requires that the belief that income chargeable to tax has escaped assessment **must have arisen in consequence of information in the possession of the Income-Tax Officer.**

From this judgement also, it is clear that the expression "reason to believe" postulates that the belief of the AO must have arisen **in consequence of information in his possession.** Here, "information" means some fresh / new material, which was not available with the AO, at the time of the assessment under section 143(3) or processing of the return under section 143(1)(a).

(iv) *Kajaria Investment and Properties Pvt. Ltd. Vs. ITO & Ors.* [2001] 250 ITR 619 (Cal.)

In this case, cost of construction shown in the books of accounts was produced at the time of assessment. The AO **formed belief** four years later, on the basis of valuation by Departmental Valuer that cost of construction was not correctly stated in the books of accounts. It was held that the AO cannot re-open assessment merely on the basis of Valuation Report of the Departmental Valuer.

It may be seen in this case, that in spite of there being a Valuation Report in favour of the Department, the action of the AO in re-opening the assessment was held to be invalid.

(v) *ITO Vs. Mahesh Kumar Pandya* [2001] 73 TTJ 194 (Jd-T)

It was held in this case that the expression '**reason to believe**' implies existence of such fact or the material on record as would reasonably lead a rational person to entertain a prima facie belief that some income has escaped assessment. The AO having re-opened the assessment merely on the basis of facts / information disclosed by the assessee and **not on a new fact / information** in the possession of the AO, issuance of notice under section 148 was void *ab initio.*

IV. Summary

The ratio decidendi of the aforesaid judgements regarding the re-opening of assessment under section 147 read with section 148, may be summarised, as follows:

(i) All the High Courts and the ITAT, including the full Bench of Delhi High Court, have held that there has been no change in the legal position after the amendment of section 147 with effect from 1.4.1989. All the old case-law will continue to apply to the proceedings under section 147 even after its amendment.

(ii) The expression 'reason to believe' still continues to be a part of main section 147 and 'reason to believe' implies that the AO must have some new / fresh facts / material in his possession for

initiating action under section 147. He is not entitled to merely change his opinion or draw a different inference from the same facts as were earlier available with him. For forming a belief that some income has escaped assessment, the AO must have in his possession some fresh / new facts / material.

(iii) There is no distinction at all between the assessment deemed to be completed under section 143(1) and the assessment completed under section 143(3) of the IT Act. This view has been further strengthened by clause 7.3 of CBDT's Circular No.549, dated 31.10.1989.

6. The belief of the AO should not be arbitrary or irrational, but based on relevant and specific information or material.

In this context, it is also important to note that there should be a direct nexus or live-link between the material coming to the notice of the AO and the formation of his belief that there has been escapement of income of the assessee. The important words under section 147 are "has reason to believe" and these words are stronger than the words "is satisfied". The belief entertained by the AO must not be arbitrary or irrational. It must be reasonable or in other words, it must be based on reasons, which are relevant and material.

In this context, it may also be noted that the Courts have got powers to examine whether the reasons are relevant and have a bearing on the matter, in regard to which, the AO is required to entertain the belief, before he issues notice under section 147. Besides, the expression "reason to believe" does not mean a purely subjective satisfaction on the part of the AO. The belief must be held in good faith; it cannot merely be pretence. In addition, suspicion, gossip or rumour would not form the basis for such belief.

In this context, the following judgements are relevant:

(i) *Ganga Saran & Sons P. Ltd. Vs. ITO & Ors.* [1981] 130 ITR 1 (SC)

The relevant observations of the Apex Court, on p.11 of the Report, are as follows:

The important words in section 147(a) are " has reason to believe" and these words are stronger than the words "is satisfied". The belief entertained by the ITO must not be arbitrary or irrational. It must be reasonable or in other words, it must be based on reasons, which are relevant and material. The Court, of course, cannot investigate into the adequacy or sufficiency of the reasons which have weighed with the ITO in coming to the belief, but the court can certainly examine whether the reasons are relevant and have a bearing on the matters in regard to which he is required to entertain the belief before he can issue notice under section 147(a). **If there is no rational and intelligible nexus between the reasons and the belief, so that, on such reasons, no one properly instructed on fact and law could reasonably entertain the belief, the conclusion would be inescapable that the ITO could not have reason to believe that any part of the income of the assessee had escaped assessment** and such escapement was by reason of the omission or failure on the part of the assessee

to disclose fully and truly all material facts and the notice issued by him would be liable to be struck down as invalid. (Emphasis added)

(ii) *ITO Vs. Nawab Mir Barkat Ali Khan Bahadur* [1974] 97 ITR 239 (SC)

It was held in this case that the expression "reason to believe" occurring in section 147 of the IT Act, 1961, does not mean a purely subjective satisfaction on the part of the ITO. The reasons for the belief must have a rational connection or a relevant bearing to the formation of the belief. (obsn. P.245 of Report)

(iii)*S. Narayanappa & Ors. Vs. CIT* [1967] 63 ITR 219 (SC)

The relevant observations are to be found on p.222 of the Report. The same are reproduced, as follows:

The expression "reason to believe" in section 34 (present section 147) of the IT Act does not mean a purely subjective satisfaction on the part of the Income-Tax Officer. The belief must be held in good faith: it cannot be merely a pretence. To put it differently, it is open to the court to examine the question whether the reasons for the belief have a rational connection or a relevant bearing to the formation of the belief and are not extraneous or irrelevant to the purpose of the section. To this limited extent, the action of the Income-Tax Officer in starting proceedings under section 34 of the Act is open to challenge in a court of law.

(iv)*Sheo Nath Singh Vs. AAC* [1971] 82 ITR 147 (SC)

The relevant observations of the Apex Court, on p.153 of the Report, are reproduced, as follows:

The words "reason to believe" suggest that the belief must be that of an honest and reasonable person based upon reasonable grounds and that the Income-Tax Officer may act on direct or circumstantial evidence but not on mere suspicion, gossip or rumour. The Income-Tax Officer would be acting without jurisdiction if the reason for his belief that the conditions are satisfied does not exist or is not material or relevant to the belief required by the section. The court can always examine this aspect though the declaration or sufficiency of the reasons for the belief cannot be investigated by the court.

(v) CIT Vs. Daulat Ram Rawatmull [1973] 87 ITR 349 (SC)

The relevant observations of the Apex Court on p.362 of the Report, are as follows:

There should, in our opinion, be some direct nexus between the conclusion of fact arrived at by the authority concerned and the primary facts upon which that conclusion is based. The use of extraneous and irrelevant material in arriving at that conclusion would vitiate the conclusion of fact because it is difficult to predicate as to what extent the extraneous and irrelevant material has influenced the authority in arriving at the conclusion of fact.

(vi) ITO Vs. Lakhmani Mewal Das [1976] 103 ITR 437 (SC)

The relevant observations on p.448 of the Report, are as follows:

"The reasons for the formation of the belief must have a rational connection with or relevant bearing on the formation of the belief. Rational connection postulates that there must be a direct nexus or live link between the material coming to the notice of the Income-Tax Officer and the formation of his belief that there has been escapement of the income of the assessee.**" and**

"At the same time, we have to bear in mind that it is not any and every material, howsoever vague and indefinite or distant, remote and farfetched, which would warrant the formation of the belief relating to escapement of the income of the assessee from assessment**"**

(vii)*Eveready Industries India Ltd. Vs. JCIT* [2000] 243 ITR 540 (Gau)

In this case, law applicable to reassessment after the amendment of section 147, with effect from 1.4.1989, has been dealt with. The High Court has emphasized that where the AO intends to take action under section 147 of the Act, he must have **reason to believe** that any income chargeable to tax has escaped assessment for any AY. Further, the "**reason to believe**" must be based on **specific information or material.**

In this instant case, a notice under section 148 was issued, on the basis of subsequent information that payment of Rs. 27,25,000/- made by the assessee company to R & G may not be genuine. No definite or specific material or information was there to show that payment made to R&G were fictitious and not genuine. The High Court has, therefore, held that the initiation of re-assessment proceedings was without jurisdiction.

(viii) Raja Bahadur Motilal P. Ltd. Vs. K.R. Vishwanathan, ITO & Anr. [1990] 183 ITR 80 (Bom.)

In this case, the assessment proceedings had been initiated under section 147(b) of the Act, on the ground that the parties from whom the assessee had made purchases as well as those to whom sales had been made, were found to be non-genuine parties and were known to have indulged in bogus havala transactions. It was held that there was no indication as to whether and in what context, these parties were found to be non-genuine parties and how they were known to have indulged in bogus havala transactions. There was also no evidence that the transactions with the assessee were bogus. The re-assessment proceedings were not valid and were liable to be quashed.

7. Other important aspects

There are certain other important aspects, which are quite relevant regarding the re-opening of the assessment under section 147. Some of them are, as follows:

(i) **Mere change of opinion cannot form the basis:**

When the primary facts necessary for assessment are fully and truly disclosed, the ITO will not be

entitled, on change of opinion to commence proceedings for reassessment. Similarly, if he has raised a wrong legal inference from the facts disclosed, he will not, on that account, be competent to commence reassessment proceedings – *CIT Vs. Bhanji Lavji* [1971] 79 ITR 582 (SC)

Having second thoughts on the same material, and omission to draw the correct legal presumption during original assessment do not warrant the initiation of a proceeding under section 147 – *ITO Vs. Nawab Mir Barkat Ali Khan Bahadur* [1974] 97 ITR 239 (SC).

(ii) **Reassessment based on new views on the same facts is not permissible:**

Income-Tax Department cannot be permitted to bring fresh litigations because of new views they entertain on facts or new versions which they present as to what should be the inference or proper inference either of the facts disclosed or the weight of the circumstances – *Sirpur Paper Mills Ltd. Vs. ITO [1978] 114 ITR 404 (AP).*

(iii) **Ignorance of law cannot form the basis:**

Where the relevant materials or facts were admittedly already available in the concerned original assessment proceedings and there were no new facts which came to the possession of the assessing authority, the said officer could not be heard to say that the legal position was not known to him even though the relevant facts and materials were available, the ignorance of law would be no ground or any excuse for the ITO concerned to reopen the assessment. – *Century Enka Ltd. Vs. ITO* [1983] 143 ITR 629 (Cal.)

(iv) **Statement by third parties cannot form the basis:**

A mere confessional statement by a third party (who is a lender of the assessee) that he was a mere name-lender and that all his transactions of loans were bogus, without naming the assessee as one who had obtained bogus loans, would not be sufficient to hold that the assessee's income had escaped assessment – *S.P. Agarwall alias Sukhdeo Prasad Agarwalla Vs. ITO* [1983] 140 ITR 1010 (Cal.)

(v) **Supreme Court decision cannot be the basis**:

The ITO cannot seek to reopen an assessment under section 147 on the basis of a Supreme Court decision in a case where the assessee had disclosed all material facts - *Indra Co. Ltd. Vs. ITO* [1971] 80 ITR 559 (Cal.)

(vi) **Ignorance of Board's Circular is not sufficient**:

The mere fact that the ITO was not aware of the circular of the Board is not sufficient to reopen an assessment – *Dr. H. Habicht Vs. Makhija* [1985] 154 ITR 552 (Bom.)

(vii) **Omission to notice facts by oversight cannot be the basis:**

When at the time of the original assessment primary facts were already before the ITO and after some routine enquiry, the ITO could have assessed the income on the basis of such information, it is not open to him to invoke the provisions of section 147 and reopen the assessment even though he

may have omitted to notice the facts mentioned in the return by oversight – *Lokendrasingh Vs. ITO* [1981] 128 ITR 450 (MP).

8. The assessee is entitled to challenge the notice under section 148 on the basis of legal and factual position vis-a-vis the reasons recorded by the AO.

While challenging the issuance of notice under section 148, after the receipt of the reasons recorded by the AO for that purpose, the assessee is entitled to challenge the action under section 147. For this purpose, the assessee may bring on record the relevant facts and also cite the relevant case-law in support of his submissions challenging the notice under section 148.

This is necessary so as to clearly establish that there is no direct nexus or live link between the material in the possession of the AO and the formation of his belief that there has been escapement of the income of the assessee.

For instance, in our case, in the reasons recorded, it is stated that payment of Rs. X, to Maharashtra State Electricity Board (MSEB) for installation of High Tension power lines is prima facie of capital nature, even though the ownership is not vested with the company and hence not allowable as revenue expenditure. It was clearly stated by us in a letter enclosed with the return of income that the amount of Rs. X, was paid to the MSEB in order to bring High Tension power lines to the factory premises from the nearest power station. That without power, the company cannot run its business and the aforesaid expenditure had not brought into existence any asset in the name of the company, because the power lines, power sub- station and other connected assets, would not belong to the company, but the ownership in respect thereof, would vest with MSEB only.

For this purpose, the provisions of section 37 (1) were explained and a number of judgements were cited, in support of our contention that such an expenditure, cannot, by any stretch of imagination, be of capital nature and therefore the same is allowable as a deduction under section 37(1) of the Act.

9. The objections against the issuance of notice under section 148, are required to be disposed of, before proceeding with the assessment.

In this context, a recent judgement of the Apex Court in the case of *GKN Driveshafts (India) Ltd. Vs. ITO* [2002] 259 ITR 19 (SC) is very relevant. The relevant observations of the Apex Court are to be found on p.20 of the Report and the same are reproduced, as follows:

"We see no justifiable reason to interfere with the order under challenge. However, we clarify that when a notice under section 148 of the Income-Tax Act is issued, the proper course of action for the noticee is to file return and if he so desires, to seek reasons for issuing notices. The Assessing Officer is bound to furnish reasons within a reasonable time. On receipt of reasons, the noticee is entitled to file objections to issuance of notice and the Assessing Officer is bound to dispose of the same by passing a speaking

order. In the instant case, as the reasons have been disclosed in these proceedings, the Assessing Officer has to dispose of the objections, if filed, by passing a speaking order, before proceeding with the assessment in respect of the aforesaid five assessment years. **"**

From the aforesaid judgement of the Apex Court, it is clear that the AO is required to dispose of the objections against the issuance of the notice under section 148, before proceeding with the assessment.

The assessee, therefore, need not supply any other information called for by the AO, before his objections against the issuance of notice under section 148, are disposed of by the AO, by passing a speaking order.

10. Conclusion

From the aforesaid discussion, it may be gauged that when a notice under section 148 is issued, the assessee must proceed in the following manner:

(i) After the issuance of notice under section 148, if the assessee is confident that there is no escapement of income whatsoever, for the relevant AY, then he should write a letter to the AO in response to the notice under section 148, to the effect that "the return of income already filed for the AY_____, may be treated to have been filed in response to the notice under section 148 dated_____".

(ii) The assessee should then keep quiet till the issuance of notice under section 143(2) in respect of re-assessment proceedings. After the receipt of notice under section 143(2), the assessee should write to the AO to supply him the reasons, recorded under section 148.

The AO is bound to furnish the reasons within a reasonable time as laid down by the Apex Court in the case of *GKN Driveshafts (India) Ltd. Vs. ITO* [2002] 259 ITR 19 (SC).

(iii) After the receipt of reasons recorded under section 148, the same should be carefully examined and if the reasons are not relevant and material, then detailed written submissions should be furnished before the AO, challenging the issuance of notice under section 148.

In this connection, the discussion in the aforesaid paras (1) to (9), must be kept in view.

(iv) The assesses should not furnish any other details called for by the AO, till his objections against the issuance of notice under section 148 are disposed of by the AO, by passing a speaking order.

(v) If the AO drops the re-assessment proceedings, then nothing further is required to be done. However, if the AO passes an order justifying his action under section 147, then such an order should be challenged in appeal, before the CIT (A).

(vi) After the AO passes an order justifying his action under section 147, the assessee may furnish the various details and other information called for by the AO.

Such a course of action will ensure that the AO reopens the assessment only on the basis of the reasons recorded under section 148 and not on the basis of any other material coming to his notice during the course of the assessment proceedings.

S. K. TYAGI
M.Sc., LL.B., **Advocate**
Ex-Indian Revenue Service
Income-Tax Advisor

☎ Office : (020) 613 3012
Fax : (020) 612 1131
Residence : (020) 668 2032
: (020) 668 2444
E-mail : sktyagidt@vsnl.com

Flat No.2, (First Floor)
Gurudatta Avenue
Popular Heights Road
Koregaon Park
PUNE - 411 001